No. 14,374

In the United States Court of Appeals for the Ninth Circuit

S. Nicholas Jacobs and Dolores I. Jacobs, petitioners

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 89-100) are reported at 21 T. C. 165.

JURISDICTION

This petition for review (R. 104-108) involves federal income tax for the calendar year 1948. On February 6, 1952, the Commissioner of Internal Revenue mailed to the taxpayers notice of a deficiency in the total amount of $42,109.63. (R. 13-14.) On May 5, 1952 (R. 3), taxpayers timely filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue

Code of 1939 (R. 5-19). The decision of the Tax Court sustaining a deficiency of $41,370.43 was entered February 4, 1954. (R. 103.) The case is brought to this Court by a petition for review filed April 30, 1954. (R. 104-108.) Jurisdiction is conferred on this Court by Section 1141(a) of the Internal Revenue Code of 1939, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether the Tax Court erred in holding that taxpayers effected a sale of land in 1948 in the ordinary course of business.

2. Whether the Tax Court erred in holding that taxpayers were bound by their election to report the gain on their tax return for the year 1948 as income for that year and are precluded from now changing to the installment method of reporting, under Section 44(b) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 44. INSTALLMENT BASIS.

*   *   *   *   *

(b) *Sales of Realty and Casual Sales of Personalty.*—In the case of (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * * *

(26 U. S. C. 1952 ed., Sec. 44.)

STATEMENT

The facts as found by the Tax Court are as follows (R. 90-96):

The taxpayers are S. Nicholas Jacobs and Dolores I. Jacobs, husband and wife, who reside in San Francisco, California. They filed their joint income tax returns for 1948 with the Collector of Internal Revenue for the First District of California. (R. 90.)

Prior to the taxable year involved, S. Nicholas Jacobs (hereinafter referred to as taxpayer) acquired certain real property in Sacramento County, California. A portion of such property had been subdivided and sold prior to August, 1946. Part of the property was included in the map of Hollywood Park Unit No. 2, hereinafter sometimes called Subdivision No. 2, which map was filed for record in the Office of the Recorder of Sacramento County on July 29, 1946. Another part of the property was included in the map of Hollywood Park Unit No. 3, hereinafter sometimes called Subdivision No. 3, which map was filed for record in the Office of the Recorder on November 25, 1947. (R. 90-91.)

In 1948, and for several years prior thereto, taxpayer had individually engaged in the subdivision and sale of his Sacramento property. During the summer of 1946, taxpayer had been advised by his counsel that, because of the undesirability of his having complete personal liability in connection with street contracts and sales of land, he should not engage in any further activity in his individual capacity with relation to subdividing and selling his Sacramento real estate. (R. 91.)

On August 28, 1946, Hollywood Subdivision, Inc. (hereinafter referred to as Subdivision), was incorporated under the laws of the State of California. Taxpayer's attorney and two of the attorney's employees were the incorporators. No capital stock was issued at that time. A permit to issue such stock in exchange for Subdivision No. 2 was filed with the Commissioner of Corporations of the State of California. This plan was subsequently abandoned when taxpayer became ill, was operated on, and went to Nevada to recuperate. (R. 91-92.)

Prior to the incorporation of Subdivision, taxpayer and his attorney did not discuss or consider the problem of whether or not taxpayer would ultimately sell the stock thereof. In addition to the undesirability of taxpayer's having complete personal liability in connection with street contracts or sales of land, taxpayer and his attorney looked into the question of income taxes, the effect thereof on taxpayer or the corporation or both jointly if instead of taxpayer engaging in the business personally, he had his corporation engage in the business of selling lots. (R. 92.)

Early in 1948, one Frank MacBride, Jr., who was in the real estate business in Sacramento, and who was the agent who had successfully sold the lots in Subdivision No. 2 that had been sold, approached taxpayer with regard to Subdivision No. 3. MacBride wished the right to sell the lots therein. He also offered to buy the lots. He was told by taxpayer's attorney, in the presence of taxpayer, that he could not buy the land; that the land was not for sale; and that he would not be permitted to be a real estate broker in the sale thereof. MacBride was informed by taxpayer's attorney, in the presence of taxpayer, that he might obtain control of the land by purchasing the stock of a corporation owning the land. The attorney further told MacBride that the stock of the corporation was not for sale at that time; that if, after the stock was issued in exchange for the land he was still interested in purchasing the stock, negotiations to that end could be instituted; but that, in the meantime, taxpayer could abandon his plan to transfer the land to the corporation in exchange for the stock, or MacBride could change his plan to submit an offer for the stock; and that the entire matter would have to be held in abeyance until the attorney's return from Washington. At this time, there was no effective permit from the California Commissioner of Corporations to issue the stock. Action to that end was instituted while the attorney was away but the application was not filed until after his return early in March, 1948. (R. 92-93.)

On March 8, 1948, Hollywood Terrace, Inc. (hereinafter referred to as Terrace), was incorporated under the laws of the State of California at the instance of Frank MacBride, Jr.; Thomas J. MacBride and Dorothy M. Baker were the incorporators. At all times material to this proceeding, Frank MacBride, Jr., owned 98 per cent of all its issued and outstanding common capital stock. Thomas J. MacBride owned one per cent thereof and Dorothy M. Baker owned one per cent thereof. At no time did taxpayer or his wife have any interest, direct or indirect, in the stock of Terrace. That corporation was at all times dominated and controlled by Frank MacBride, Jr. (R. 93.)

The permit to issue stock was granted to Subdivision by the Commissioner of Corporations of the State of California on March 29, 1948. On or about April 1, 1948, taxpayer exchanged Subdivision No. 3 for 1,750 shares of $100 par value stock of Subdivision. Prior to the issuance of any of the stock of Subdivision, MacBride made an appraisal of the real estate in controversy. He valued it at $175,000. (R. 94-95.)

On or about April 5, 1948, taxpayer's attorney arranged for the "sale" of taxpayer's stock to Terrace. At that time, taxpayer received a promissory note in the sum of $175,000 from Terrace, which corporation had little or no assets other than the stock of Subdivision, thereby acquired. Such stock was pledged by an instrument of pledge to taxpayer. It was reissued in the name of Terrace, and then was reissued in the name of taxpayer as pledgee. At that point in the transaction, taxpayer was the owner of a promissory note having a fair market value when received in 1948 of $125,000, which note was secured by 1,750 shares of the common stock of Subdivision. Subdivision continued to be the owner of the real estate, and Terrace was the owner of the 1,750 shares, subject to the pledge to secure the promissory note. Thereafter and on April 6, 1948, MacBride, in writing, requested permission to alter the plans concerning the subdivision and to dissolve Subdivision. Such permission was granted by taxpayer and Subdivision was dissolved on or about April 8, 1948, by one or more or all of Frank MacBride, Jr.; Thomas J. MacBride, and Dorothy M. Baker. At this point, taxpayer was the holder of the promissory note in the sum of $175,000, which note was secured by a deed of trust on Subdivision No. 3. (R. 94.)

Prior to April 5, 1948, Subdivision never had a bank account, it never paid any salaries to any employees, it never had any books of account, it never bought or sold any real estate or any personal property, and it had not entered into any business transactions of any kind. (R. 94-95.)

The promissory note of Terrace, held by taxpayer, was liquidated in the years 1948 through 1951, as follows (R. 95):

Year	*Payment*
1948	$28,364.57
1949	74,762.98
1950	12,225.77
1951	7,201.41

On the federal income tax return filed by taxpayer and his wife for the year 1948, they did not elect to report on the installment basis their gain on the sale of the property which they sold for $175,000 in such year. (R. 95.)

In addition, the Tax Court made the following ultimate findings of fact (R. 95-96):

The conveyance of Subdivision No. 3 to Hollywood Subdivision, Inc.; the issuance of the stock of Hollywood Subdivision, Inc., to taxpayer; the transfer of such stock by taxpayer to Hollywood Terrace, Inc., and the receipt by taxpayer of a note in the sum of $175,000 were component parts of a single transaction, by which taxpayer effected a sale of land in the ordinary course of business. The corporation known as Hollywood Subdivision, Inc., served no business purpose and performed no business function other than to act as a conduit to transfer the title to Subdivision No. 3 from taxpayer to a purchaser of such real estate.

The computation of taxpayer's tax liability for the years 1948 through 1951 (Br. 8) based upon taxpayer's theory of their liability, is based solely on the computations made by taxpayer's accountant (R. 65-69) and was not accepted as accurate by counsel for the Commissioner (R. 70), who stated, with the court agreeing, that a recomputation would be done under Rule 50 of the Rules of Practice of the Tax Court (R. 83).

SUMMARY OF ARGUMENT

The Tax Court correctly found that the sale here was a single transaction, the sale of land, and correctly determined that the gain derived therefrom constitutes and is taxable as ordinary income. Its finding was not clearly erroneous and is supported by the evidence.

It is well settled that an entire transaction may not be broken into several steps with each step treated separately for income tax purposes. Whether there is in reality a single transaction or several transactions is a question of fact, particularly where the question is as to who has made a sale. This question of fact is for the determination of the trial court, which may consider all the circumstances, including motives, intent, and conduct, and whose finding of this fact must be sustained unless clearly erroneous.

In the present case the evidence is clear that there was but a single transaction. Taxpayer was willing to dispose of his land, and did so. He transferred it to a corporation for stock, intending immediately to sell the stock. The form of the transaction was selected solely to avoid taxes and with the intention that it be merely a form. The corporation served no business purpose and had no active life. The entire transaction took but a few days and was carried on with a single purchaser who was fully advised of the purpose of the steps being taken and of his part in them. The Tax Court's finding was not merely not clearly erroneous but was amply supported by the evidence.

II

Taxpayer in his return for the calendar year 1948 reported the gain as income for that year. Although he might have reported it on the installment basis he did not do so. The Tax Court correctly held him bound by his election, applying the rule set out in decisions of this Court and of the Supreme Court.

No basis appears for carving an exception out of that rule. The method chosen by the taxpayer did in fact reflect his income for the year; there was no mistake of fact; his election was based upon full information as to the tax consequences.

ARGUMENT

I

The Tax Court did not err in holding that taxpayers effected a sale of land in 1948 in the ordinary course of business

In this proceeding taxpayers are contending that by transferring to a corporation land held for sale to customers in the ordinary course of business in exchange for the corporation's stock, and then selling the stock to a purchaser they realized capital gain on a sale of corporate stock rather than ordinary income from the sale of land. The Tax Court held that there was a single transaction, a sale in the ordinary course of business, and that the gain derived therefrom constitutes and is taxable as ordinary income. (R. 98.) We submit that the Tax Court's decision was correct.

It is well settled that each step in an entire transaction cannot be treated separately for income tax purposes. *Barker* v. *United States,* 200 F. 2d 223, 231 (C. A. 9th); *Halliburton* v. *Commissioner,* 78 F. 2d 265, 267 (C. A. 9th). As the Supreme Court said in *Commissioner* v. *Court Holding Co.,* 324 U. S. 331, 334:

> The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. *A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a con-*

> *duit through which to pass title.** To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax labilities, would seriously impair the effective administration of the tax policies of Congress. (Italics supplied.)

It is equally well settled that whether there is a single transaction or several is a question of fact. *Von's Inv. Co.* v. *Commissioner,* 92 F. 2d 861, 864 (C. A. 9th); *Commissioner* v. *Laughton,* 113 F. 2d 103, 104 (C. A. 9th); *Heller* v. *Commissioner,* 147 F. 2d 376, 378 (C. A. 9th); *Houck* v. *Hinds* (C. A. 10th), decided August 20, 1954 (1954 P-H, par. 72,742). In *Dobson* v. *Commissioner,* 320 U. S. 489, 502, the Supreme Court so referred to it:

> Whether an apparently integrated transaction shall be broken up into several separate steps and whether what apparently are several steps shall be synthesized into one whole transaction is frequently a necessary determination in deciding tax consequences. Where no statute or regulation controls, the Tax Court's selection of the course to follow is no more reviewable than any other question of fact.

These principles have been applied to sales by a corporation through its stockholders, the trial court in *Commissioner* v. *Court Holding Co., supra,* p. 454, finding that the sale was made by the corporation and that there was an attempt "to disguise a corporate sale

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**Gregory* v. *Helvering,* 293 U. S. 465; *Minnesota Tea Co.,* v. *Helvering,* 302 U. S. 609; *Griffiths* v. *Commissioner,* 308 U. S. 355; *Higgins* v. *Smith,* 308 U. S. 473.

through the use of mere formalisms in order to avoid tax liability," and in *United States* v. *Cumberland Pub. Serv. Co.,* 338 U. S. 451, that it was made by the stockholders. In the *Cumberland Pub. Serv. Co.* case the Supreme Court (338 U. S. at 456) stated that:

> It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs. Here as in the *Court Holding Co.* case we accept the ultimate findings of fact of the trial tribunal.

In the present case, of course, the specific question is not whether there was a sale by the corporation, but whether there was a sale by taxpayers using "mere formalisms" in order to avoid tax liability. The principles involved are similar, however, and equally applicable is the Court's reiteration of "the established principle" that "fact-finding tribunals in tax cases can consider motives, intent, and conduct in addition to what appears in written instruments used by parties to control rights as among themselves." *United States* v. *Cumberland Pub. Serv. Co., supra,* at 454, fn. 3.

This Court has repeatedly held that questions of fact are for the trial court, whose findings must be sustained if supported by substantial evidence. See, for example, *Goold* v. *Commissioner,* 182 F. 2d 573, 575; *Kennedy Name Plate Co.* v. *Commissioner,* 170 F. 2d 196; *Hirsch* v. *Commissioner,* 124 F. 2d 24, 28; *Doernbecher Mfg. Co.* v. *Commissioner,* 80 F. 2d 573; *Anderson* v. *Commissioner* 78 F. 2d 636, 638. See also *United States* v. *Cumberland Pub. Serv. Co., supra.*

In the present case the Tax Court found (R. 95):

> The conveyance of Subdivision No. 3 to Hollywood Subdivision, Inc.; the issuance of the stock of

> Hollywood Subdivision, Inc., to petitioner; the transfer of such stock by petitioner to Hollywood Terrace, Inc., and the receipt by petitioner of a note in the sum of $175,000 were component parts of a single transaction, by which petitioner effected a sale of land in the ordinary course of business.

This finding was not merely not clearly erroneous (cf. Rule 52(a), Federal Rules of Civil Procedure); it was amply supported by the evidence.

The essence of the transaction is simple. Taxpayer was the owner of certain real property in Sacramento County which he was engaged in subdividing and selling. (R. 90-91.) Early in 1948, Frank MacBride, Jr., offered to buy the lots in Subdivision No. 3. (R. 92.) By April 8, 1948, taxpayer had disposed of Subdivision No. 3 and was no longer the owner; Subdivision No. 3 was owned by a corporation formed by MacBride in March; taxpayer was the holder of a note for $175,000, the fair market value of the land, given by that corporation, secured at first by a pledge of stock in a corporation which had title to the land and then by a deed of trust on the land. (R. 93-94.) On its face this was a sale of land, and that is what it was. Taxpayer was in the business of selling land; he sold some.

The court below properly stated that the formal steps taken by taxpayer were of no avail taxwise (R. 97) to change this transaction into something other than what it was. An avowed purpose of those steps was to avoid or minimize taxes. (R. 32-33.) It is, of course, true that taxpayers may select that form of doing business which will minimize taxes, but this is not applicable where—"The whole undertaking * * * was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else." *Gregory* v. *Helvering,* 293 U. S. 465, 469. The Tax Court, in the case cited by taxpayer (Br. 21), *Trousdale* v. *Commissioner,* 16 T. C. 1056, immediately following its comments on the permissibility of decreasing taxes, continued as follows (p. 1065):

> But when such is the primary motive of a particular transaction, that transaction should be closely scrutinized. If, after considering all of the actualities, it is found to be but a subterfuge, it may then be disregarded for tax purposes. Substance will prevail over form.

It then found that "the entire transaction was but a cloak for the purpose of decreasing petitioner's tax * * *." Similarly, in *Hopkins* v. *Commissioner,* 15 T. C. 160, 179, also cited by taxpayer in his brief (pp. 18-20) the court cautioned:

> If the testimony indicated that petitioner had formed the corporation to obtain a deductible loss on liquidation which he could not obtain on the sale by either himself or the corporation to his sisters, then it would be incumbent upon us to seek out the substance of the transaction, treat the corporation as petitioner's *alter ego,* and deny him a loss upon liquidation.

From the fact that taxpayer desires to avoid taxes it does not follow that he must fail. Conversely, that he avows a desire to avoid taxes does not mean that he shall succeed. On the contrary, that desire is relevant in showing the intent of the transaction. As the Supreme Court pointed out in *United States* v. *Cumber-*

land Pub. Serv. Co., at p. 454, "in resolving such questions as who made a sale, fact finding tribunals in tax cases can consider motives, intent, and conduct * * *." Or as this Court said in *Von's Inv. Co.* v. *Commissioner,* 92 F. 2d 861, 863—"Whether the two transfers here involved should or should not be treated as one transaction depends upon the intent and purposes with which they were made."

In the second place, as the court below found (R. 95-96) the corporation known as Hollywood Subdivision, Inc., served no business purpose and performed no business function other than to act as a conduit to transfer the title to Subdivision No. 3 from taxpayer to a purchaser. In 1946 initial steps had been taken to form a corporation with a business purpose, to insulate taxpayer from a personal liability in connection with the subdivision and sale of lots in Subdivision No. 2 (R. 30, 31, 48, 91) but no stock was issued or property acquired, and that project was abandoned (R. 48, 50, 91-92). The dormant corporation was revived only after MacBride expressed a desire to buy the land and was told he might acquire it by buying the stock of the corporation. (R. 50-51.) Thereafter, on March 29, 1948, a permit was issued by the Commissioner of Corporations, authorizing issuance of stock (R. 54); by April 2, 1948, the stock was issued in exchange for the lots (R. 55); on or about April 5, 1948, the stock was sold to MacBride's corporation (R. 94); on April 6 MacBride asked permission to dissolve Hollywood Subdivision, Inc. (R. 94); and on April 8 it was dissolved (R. 85-88, 94).

During its brief lifetime Hollywood Subdivision, Inc,. prior to April 5, 1948, never had a bank account, it never paid any salaries to any employees, it never had any books of account, it never bought or sold any real estate or any personal property, and it had not entered into any business transactions of any kind. (R. 60, 94-95.)

It is clear that the corporation had no business purpose at the time it was in existence. Taxpayer's brief (pp. 10-11) argues that there was a business purpose to be served in 1946, which is irrelevant here. The purposes then contemplated were not served and the project abandoned. Taxpayer also argues as to the necessity of a business purpose for a corporation to issue stock (Br. 22-23), which is irrelevant to the question whether the corporation itself served any business purpose. *Bond* v. *Commissioner*, 14 T. C. 478, and *Herbert* v. *Riddell*, 103 F. Supp. 369 (S.D. Cal.), cited by taxpayer (Br. 21-22), involved corporations which the courts found actually did some business. Here the corporation did nothing but exist for a brief period, to serve the purpose of tax avoidance. "Escaping taxation is not a 'business' activity." *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422, 437.[1]

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[1] We do not see the relevance of taxpayer's discussion of collapsible corporations. (Br. 37-40.) The problem there was as to the treatment of income from the sale of stock in corporations which concededly had an active life, were actively engaged in doing business, and as such had a business purpose. The effect of Section 212 of the Revenue Act of 1950, c. 994, 64 Stat. 906, was that even though these corporations were really engaged in doing business, gains from the sale of their stock would, under the prescribed conditions, be taxable as ordinary income rather than as capital gains. We do not see how the fact that gains from the sale of stock in a corporation which has engaged in "the manufacture, construction, or production of property" may now, in some circumstances, be taxed as ordinary income casts any light upon the question whether a corporation which did none of those

In the third place, there is evidence to support the court's statement that even if there was no enforceable agreement or binding commitment on the part of taxpayer to sell his stock in the corporation prior to its issuance to him, it is properly to be inferred that there did exist an understanding to such effect, albeit implied. (R. 97.) One element to be considered is the timing. "In determining whether a series of steps are to be treated as a single indivisible transaction or should retain their separate entity, the courts use a variety of tests * * *. Among the factors considered are the intent of the parties, the time element, and the pragmatic test of the ultimate result." *American Bantam Car Co.* v. *Commissioner,* 11 T. C. 397, 405, affirmed *per curiam,* 177 F. 2d 513 (C. A. 3d), certiorari denied, 339 U. S. 920. Here on April 1 the corporation issued its stock and four days later the sale was arranged, to a purchaser who had previously been attempting to purchase the land. (R. 93-94.)

Nor does it require a suspicious eye to discern in the conversations of taxpayer's counsel with MacBride an implied understanding that a sale would be made.[2] MacBride was "told that he might be able to acquire

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things had any substance for tax purposes. Furthermore that section specifically admonishes that—"The determination of the tax treatment of gains realized prior to January 1, 1950, shall be made as if this section had not been enacted and without inferences drawn from the fact that the amendment made by this section is not expressly made applicable to gains realized prior to such date and without inferences drawn from the limitations contained in section 117(m), added to the Internal Revenue Code by this section."

[2] Taxpayer's brief (pp. 12-14) discusses this issue in terms of Section 112(b)(5) of the Internal Revenue Code of 1939, but its relevance is remote since taxpayer is not being taxed on the transfer to the corporation but on the sale as a whole.

control of the land by buying the stock of the corporation that owned it all." (R. 50-51.) "He was told that there would be no program for a commitment, that we could run out, he could run out of it, and that there was never to be anything binding, but that nothing could be done until after I returned from Washington." (R. 52-53.) "* * * Mr. MacBride was told that if he didn't want to buy some stock in Hollywood Subdivision, Inc., there was no further thing for us to do. I was very careful to be plain, pointed and meticulous that either party could run out on the other. * * * This wasn't one transaction. We were careful to maintain that differentiation." (R. 32-33.) This was more than to offer a faint hope; it was a clear statement that the owner was prepared to dispose of the land. There was something which both parties were to be free to "run out of."

Prior to that time MacBride had been advised by taxpayer's counsel that to avoid personal liability "he had better form a corporation and have that so that if that step ever arrived, he could do that." (R. 35.) Certainly counsel was not advising him to take such a step, carried out in March, if there was to be no sale.

There is even evidence in the record from which it might be inferred that a price had been agreed upon prior to the issuance of the stock. MacBride, who was actively interested in becoming a purchaser, and who paid $175,000 for the stock, was used as the appraiser to set a fair market value on the land in order to obtain the permit from the Commissioner of Corporations for issuance of the stock in exchange for the land. (R. 34, 54, 94.) That appraisal was $175,000. (R. 54, 94.) It may properly be inferred that this had been a negotiated figure in view of the fact that a man actively interested in buying the land was chosen by taxpayer as his independent appraiser. Support is lent to this inference by the remark of taxpayer's counsel that the figure of $175,000 "turned out afterwards not to be as good as we thought." (R. 54.)

Taxpayer appears to argue that there could have been no such prospective commitments because they would have been "void" under the statute of frauds. (Br. 12-13.) That an agreement is unenforceable does not mean that there was no agreement. In any event, if executed, it cannot be attacked under that statute. See *James* v. *Hall,* 88 Cal. App. 528, 264 Pac. 516; *Atkinson* v. *Boynton,* 97 Cal. App. 759, 276 Pac. 356; *McComsey* v. *Leaf,* 36 Cal. App. 2d 132, 97 P. 2d 242. Taxpayer also argues that a contract to sell the stock, made before its issuance, would violate the California Corporate Securities Law. (Br. 24-25.) The Tax Court did not find that there was an "enforceable agreement" or "binding commitment" to sell the stock (R. 97) nor do we claim that there were such. The issue for federal tax purposes is as to the intent of the parties and their understanding as throwing light on whether the transaction was a single one. As this Court remarked in *Faris* v. *Helvering*, 71 F. 2d 610, 611, certiorari denied, 293 U. S. 584: "Neither the action of the state commissioner of corporations nor of the corporation is decisive of the matter, which is controlled by the Revenue Laws of the United States." To adopt a procedure in forming a corporation which complies with state laws is not to say that the corporation so formed has a business purpose under the federal tax laws.

Taxpayer finally suggests in his brief (pp. 37, 40-41) that a business purpose can be found in the fact that a deficiency judgment can be obtained on the sale of corporate stock though not on the sale of real estate. There is no evidence in the record that this was in mind at the time of the transaction, and it is inconsistent with the advice of taxpayer's counsel to MacBride that he form a corporation, with limited liability, to purchase the stock.

II

The Tax Court correctly held that taxpayers were bound by their election not to report the gain from the sale in their tax return for the year 1948 on the installment method

In his tax return for 1948 (R. 74) taxpayer reported the gain on this transaction as income for that year, entering as income the fair market value of the note, \$125,000, and the basis of the property as \$38,693.36. The transaction was reported as a sale of capital stock in "Hollywood, Park, Inc.," acquired in 1936. Taxpayer now asserts (Br. 31) that having made a mistake of law in reporting the transaction as capital gain, if this Court agrees with the Tax Court on that issue, he is now entitled to have the transaction treated as a sale on the installment basis.

He states his position as follows (Br. 31):

> Election implies an intentional choice. This, the taxpayer did not have when he filed his return, he then believing the transaction to be a capital gain. Taxpayer is now entitled to make that choice if the transaction is held to be a sale of land and not a sale of stock.

As we understand this argument, he is asserting that a gain on the sale of a capital asset cannot be reported on the installment basis, and that accordingly at that time, believing the sale to be that of a capital asset, he had no choice.

The difficulty with taxpayer's argument is its basic assumption. Capital gains can be reported on the installment basis. Section 111(d), Internal Revenue Code of 1939; 2 Mertens, Law of Federal Income Taxation, Section 15.11. This is so clear that the question appears not to have been directly litigated (see 1954 P-H Federal Tax Service, par. 6665), and to have been assumed in such cases as *Commissioner* v. *Swift,* 54 F. 2d 746 (C. A. 9th); and *Snell* v. *Commissioner,* 97 F. 2d 891 (C. A. 5th). Whether the sale was of real estate or of stock taxpayer then had an option to report the gain on the installment basis. *Golden* v. *Commissioner,* 47 B.T.A. 94; *50 East 75th St. Corp.* v. *Commissioner,* 78 F. 2d 158 (C. A. 2d). Having chosen not to report on that basis he cannot now change his mind. The Tax Court correctly applied the rule laid down in *Pacific National Co.* v. *Welch,* 304 U. S. 191, and *United States* v. *Kaplan,* 304 U. S. 195.

Even if taxpayer's mistake of law in reporting the sale as one of a capital asset were relevant to this issue, this Court in the *Pacific National Co.* case, 91 F. 2d 590, 593, rejected the argument that the reporting was "a mistake and not an election" in language applicable here:

> By filing its return of that basis it made a choice or election and it may not, at a later date, when it appears to its advantage to do so, change the method of making its report. *Rose* v. *Grant* (C. C. A. 5) 39 F. (2d) 340, 341; *Safety Electric Prod. Co., Inc.* v. *Helvering* (C. C. A. 9) 70 F. (2d)

> 439, 441; *Alameda Inv. Co.* v. *McLaughlin* (C.A.A. 9) 33 F. (2d) 120; *U. S.* v. *Pettigrew* (C.C.A. 9) 81 F. (2d) 666. "The courts have uniformly held that the right of choice or election to file one or another sort of return is exercised by filing the return." *Radiant Glass Co.* v. *Burnet,* 60 App. D.C. 351, 54 F. (2d) 718, 719. "The present case is not different in principle from those in which a taxpayer, having the right to file either one of two different sorts or returns, makes his choice and files his returns accordingly. It is settled that he cannot afterwards change. *Radiant Glass Co.* v. *Burnet,* * * * [*supra*]. This is so even where the taxpayer, under a mistake of law, was unaware that he had the right to choose. *Buttolph* v. *Commissioner,* 29 F. (2d) 695 (C.C.A. 7)." *Moran* v. *Commissioner of Internal Revenue* (C.C.A. 1 67 F. (2d) 601, 602. (Italics our own.)

The Supreme Court, affirming the decision of this Court, 304 U.S. 191, 194-195, agreed that "By reporting income from the sales in question according to the deferred payment method, petitioner made an election that is binding upon it and the Commissioner." The Court also pointed out (pp. 193-194) that where notes are taken at market value, as in the present case, the deferred payment clearly reflects income.

This is but an application of the well-established principle that if a taxpayer selects one of two or more methods for reporting income he may not subsequently change this method, either by filing an amended return or otherwise. *Riley Co.* v. *Commissioner,* 311 U. S. 55; *Helvering* v. *Wilshire Oil Co.,* 308 U. S. 90; *Alameda*

Inv. Co. v. *McLaughlin*, 33 F. 2d 120 (C. A. 9th); *Commissioner* v. *Saunders*, 131 F. 2d 571 (C. A. 5th); *Moran* v. *Commissioner*, 67 F. 2d 601 (C. A. 1st); *Strauss* v. *Commissioner*, 87 F. 2d 1018 (C. A. 2d); *Marks* v. *United States*, 98 F. 2d 564 (C. A. 2d), certiorari denied, 305 U. S. 652; *Thrift* v. *Commissioner*, 15 T. C. 366.

Key Largo Shores Properties, Inc. v. *Commissioner*, 21 B. T. A. 1008, and *Ives Dairy, Inc.* v. *Commissioner*, 23 B.T.A. 579, cited by taxpayer (Br. 34), involved sales made during the Florida land boom where notes were given for the purchase of land, and within the taxable year the boom collapsed and the notes lost their value. The Board of Tax Appeals concluded that to hold taxpayers to their election to report on the installment method would not clearly reflect income for the taxable year. *United States* v. *Eversman*, 133 F. 2d 261 (C. A. 6th), may be considered as falling within the same category. Furthermore, in that case the court emphasized that a complete disclosure of all relevant facts had been made on the taxpayer's return. In *Scales* v. *Commissioner*, 211 F. 2d 133 (C.A. 6th), the taxpayer made a mistake in reporting the transaction as a lease rather than a sale. Here the transaction was reported as a sale and was in fact one. Accordingly taxpayer had an election in filing his return for 1948 as to how he would report the gain.

There is no merit in taxpayer's contention in the present case (Br. 29-30) that treating the gain as received in 1948 distorts his income for that year. It is stipulated that the note, of a face value of $175,000, then had a fair market value of $125,000 (R. 25), and it was in fact liquidated by subsequent payments (R. 95).

There was no mistake as to the facts. Taxpayer at that time chose to report the gain as income. He was informed as to the facts and the law, and his election was far more fully advised than that held binding by this Court in the *Pacific National Co.* case, *supra.* Most important, taxpayer, regardless of whether the sale was one of stock or of land, had an election whether to report the income on the installment basis or not. Accordingly, the fact that he erred in treating the sale as one of stock cannot enlarge his rights.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted.

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